Office of Lender Activities & Program Compliance

Loan Review System (LRS): Implementation and Process Changes

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Agenda

- Loan Review System (LRS) Overview

- Business Process Changes

    — Test Cases

    — Lender Monitoring Reviews

    — Lender Self-Reporting

- Defect Taxonomy

- Upcoming Activities

Loan Review System (LRS) Overview

Loan Review System

The Federal Housing Administration (FHA) manages the risks to Single Family insurance programs through various quality control processes.

FHA is committed to balancing risk management while meeting the needs of its target population.

A unified loan review process improves FHA quality control, making it more consistent & transparent.

Loan Review System (cont.)

- Enables a unified loan review process in a single system

- Implements Defect Taxonomy

Loan Review System (cont.)

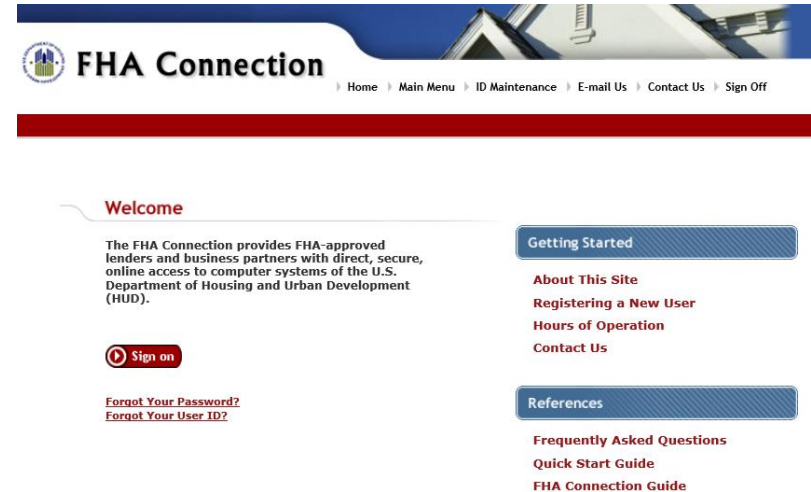|		
Test Cases & Post-Endorsement Loan Reviews	• **eFindings Letter & Notifications** • **Underwriter Review System**	
Lender Monitoring Reviews of Underwriting, Servicing & Operations	• **Email Notifications/Requests** • **Manual Processes**	**All functions in ONE Loan Review System (LRS)**
Self-Reporting of Fraud/Misrepresentation & Other Material Findings	• **Neighborhood Watch**	
Responding to Findings	• **Mail/eMail to HOC**	
Reports & Summary Data	• **Multiple Source Systems**	

Access & User Roles

- LRS accessed via FHA Connection

- Lender's Application Coordinator grants user access

- Three possible roles:
  1. Read Only
  2. Response Submission
  3. Indemnification Submission

Lender Dashboard

Responding to Findings

- Administrative Contact (registered in LEAP) notified by email when findings require a response

- All review details/history available in LRS

- Directly upload documentation and written responses

- May submit indemnification agreements electronically

Data & Reporting

- Reports available in LRS using MicroStrategy:
    - Loan Quality (material defect rates/details)
    - Request Processing/Timelines
    - Random Sample Outcomes

- Data from all review types in aggregate or in separate categories

- Download raw data to build your own reports

Data & Reporting (cont.)

LRS — Active Reviews | Binder Request | Create Self-Report | Completed Reviews | **Reports** — Signed in as Lender Jones

FHA MORTGAGE COMPANY (86420)

Material Defects

Quarter	# of Loans	Gross #	Gross %	Quartile	Net #	Net%	Quartile
2014 Q4	56	6	10.7%	3	0	0.0%	4
2015 Q1	34	6	17.6%	3	2	5.9%	1
2015 Q2	34	6	17.6%	1	2	5.9%	3
2015 Q3	26	4	15.4%	4	0	0.0%	1
2015 Q4	14	2	14.3%	1	0	0.0%	1
2016 Q1	156	14	9.0%	3	0	0.0%	2
2016 Q2	100	16	16.0%	4	0	0.0%	2
2016 Q3	94	10	10.6%	2	2	2.1%	3
Total	**514**	**64**	**12.5%**	--	**6**	**1.2%**	--

Gross % ● Net % (Dashes=National Avg)
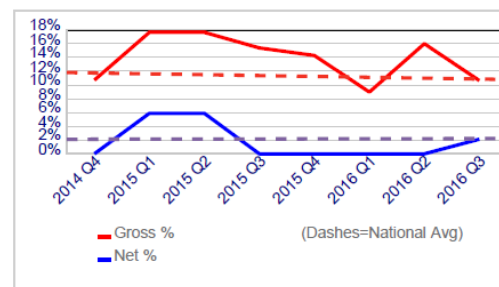
Review Ratings #

Quarter	Conforming	Deficient	Mitigated	Remediated	Indem	Other
2014 Q4	38	4	6	0	8	0
2015 Q1	22	4	4	0	2	2
2015 Q2	20	4	4	0	4	2
2015 Q3	18	2	4	0	2	0
2015 Q4	12	0	2	0	0	0
2016 Q1	124	2	14	0	16	0
2016 Q2	72	4	16	0	8	0
2016 Q3	66	10	8	0	8	2
Total	**372**	**30**	**58**	**0**	**48**	**6**

Review Ratings %

Quarter	Conforming	Deficient	Mitigated	Remediated	Indem	Other
2014 Q4	67.9%	7.1%	10.7%	0.0%	14.3%	0.0%
2015 Q1	64.7%	11.8%	11.8%	0.0%	5.9%	5.9%
2015 Q2	58.8%	11.8%	11.8%	0.0%	11.8%	5.9%
2015 Q3	69.2%	7.7%	15.4%	0.0%	7.7%	0.0%
2015 Q4	85.7%	0.0%	14.3%	0.0%	0.0%	0.0%
2016 Q1	79.5%	1.3%	9.0%	0.0%	10.3%	0.0%
2016 Q2	72.0%	4.0%	16.0%	0.0%	8.0%	0.0%
2016 Q3	70.2%	10.6%	8.5%	0.0%	8.5%	2.1%
Total	**72.4%**	**5.8%**	**11.3%**	**0.0%**	**9.3%**	**1.2%**

Gross Rating - 2 Year Average

21.4% · 21.8% · 56.8%

Conforming · Deficient · Unacceptable

Net Rating - 2 Year Average

5.8% · 11.3% · 9.3% · 1.2% · 72.4%

Conforming · Deficient · Mitigated · Remediated · Indem · Other
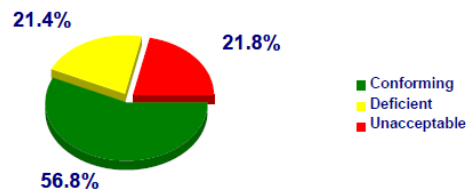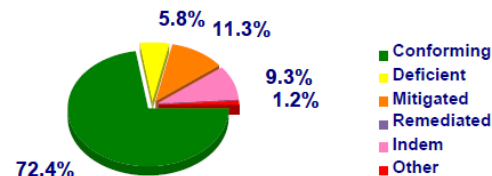
Business Process Changes

Test Cases

- Mortgagee Letter 2016-21

- New procedures for lenders approved on or after April 1, 2017

- Test cases will be reviewed post-closing

- Multiple opportunities to cure underwriting defects

- Acceptable rating results in Mortgage Insurance Certificate (MIC)

- Unacceptable Rating results in Notice of Return (NOR)

Lender Monitoring Reviews

- Email notification from LRS with list of selected loans

- On-site visit to focus on internal controls, operations, and QC Plan

- Most loans reviewed before the on-site visit

- Lender responses via LRS for operational and loan-level findings

Lender Self-Reporting

- Self-Report function replaces "Lender Reporting" in Neighborhood Watch

- Simplified data collection—from 36 to 6 critical data elements

- Report single or multiple loans with upload capability

- Automatically generates request for binder

Lender Self-Reporting (cont.)

Defect Taxonomy

Defect Taxonomy

FHA Office of Single Family Housing

FHA's Single Family Housing Loan Quality Assessment Methodology

(Defect Taxonomy)

June 18, 2015

Defect Taxonomy

What is it?

- Method of identifying defects and their sources, causes, and severities

- Provides useful data and feedback through structured categorization of defects

- Balances risk management and business processes

Defect Taxonomy (cont.)

Defect Areas

1. Borrower Income **(BI)**

2. Borrower Credit **(BC)**

3. Loan to Value/Maximum Loan Amount **(LM)**

4. Borrower Assets **(BA)**

5. Property Eligibility **(PE)**

6. Property Appraisal **(PA)**

7. Borrower Eligibility **(BE)**

8. Mortgage Eligibility **(ME)**

9. Lender Operations **(LO)**

Defect Taxonomy (cont.)

Causes

Sources

- Each Defect Area has a set of possible sources and causes

- Sources are numbered 1, 2, 3…

- Causes are lettered A, B, C…

- Each finding in LRS will be coded by distinct Defect Area/Source/Cause
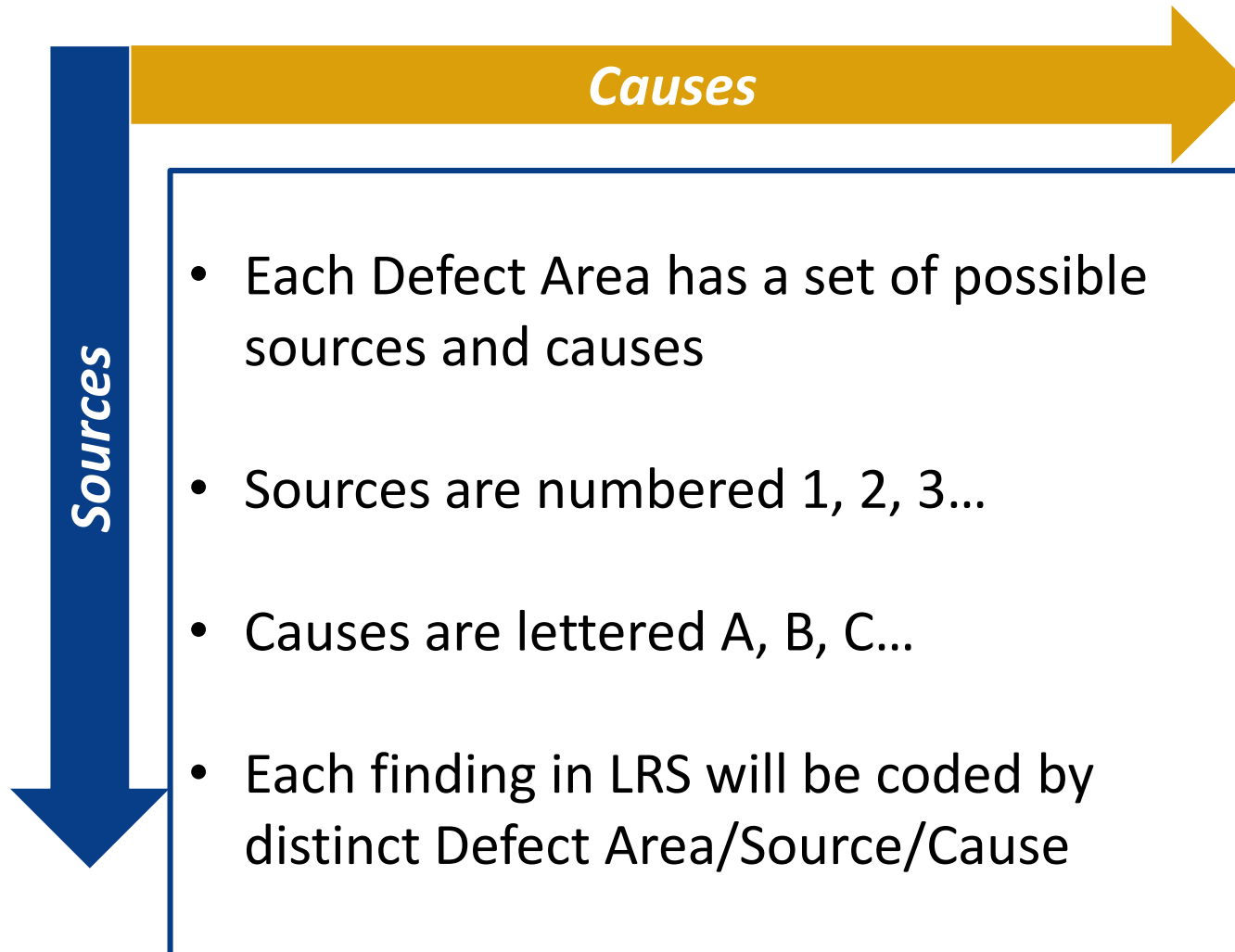
Defect Taxonomy (cont.) *Sample – Property Eligibility (PE)*

	Sources	Causes			
1	MPR and General Acceptability Criteria	**A**	**B**	**F**	**G**
2	Property zoning does not meet policy	Determinations are not supported by documents provided	Determinations supported by documentation but FHA policy is improperly applied	Possible Mis-Representation or Fraud *(Lender did not know or could not have known)*	Possible Mis-Representation or Fraud
3	Property flood requirements not met				
4	Manufactured home ineligible				
5	New Construction ineligible				
6	Property fails to adhere to flipping guidelines				
7	Condo project not approved or withdrawn				
8	Condo – loan level issues				
9	Repairs not completed or repair escrow account not established				
10	Required compliance inspections not completed				
11	Property not acceptable				
12	Non-MPR repair issues/escrow account not established				
13	Other				

Defect Taxonomy (cont.) *Severity Assessment*

- Four possible severity tiers

- Severity is driven by the impact on insurability

- Measured by nature of the deviation from FHA's requirements

- Finding notification will include the tier of each defect

Tier 1 **Tier 2** **Tier 3** **Tier 4**

Defect Taxonomy (cont.)

Tier 1

- **Fraud/Misrepresentation**

- **Violations of statutory requirements**

- **Significant eligibility or insurability issues**

- **Inability to determine/support loan approval**

Tier 2

- **Material errors that impact loan approval**

- **Failure to comply with FHA policy**

Defect Taxonomy (cont.)

Tier 3

- **Minor errors or issues impacting approval**

- **Failure to comply with guidelines by small degree**

Tier 4

- **Errors that impact calculations or data integrity**

- **Loan would have been approvable despite errors**

Upcoming Activities

Upcoming Activities

- Mortgagee Letter to confirm LRS go-live date

- Additional webinars before and after system implementation

- User documentation posted prior to go-live

- FHA INFO notices

References

- Mortgagee Letters 2016-21 (Test Cases) and 2017-03 (LRS Implementation) https://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/letters/mortgagee

- Defect Taxonomy https://portal.hud.gov/hudportal/documents/huddoc?id=SFH_LQA_Methodology.pdf

- Lender Insight http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/lender/SFH_Lender_Insight

- FHA INFO provides the lending industry updates on new Mortgagee Letters, Handbooks, and other notices, as well as a FHA Housing Industry Training. Lenders may subscribe to this e-mail distribution through the "subscribe to FHA INFO" link on the HUD Resources section of the main FHA lender web page at www.hud.gov/lenders

The FHA Resource Center

- Origination through Endorsement FAQs on SF Handbook Information page:
  - Commonly asked questions/detailed answers.
  - Uploaded to the online Knowledge Base.

- www.hudanswers.gov: 1900+ Qs and As addressing 90 percent of our phone calls and announcements of policy changes and training opportunities.

- Email: answers@hud.gov
- Phone: (800) CALL-FHA or (800) 225-5342
- TTY: 1-800-877-8339
- Monday through Friday 8:00am – 8:00pm Eastern

Thank You!